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# Cases, Regulations and Statutes

Robert P. Achenbach Jr
*Iowa State University*

# CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

## BANKRUPTCY

### FEDERAL TAX

**EXEMPTIONS**.

ADDITIONAL CHILD TAX CREDIT. The debtor filed for Chapter 7 and claimed an exemption, under Iowa Code § 627.6, for a federal income tax refund attributable to the additional child tax credit and the earned income tax credit. The trustee objected to the exemption for the additional child tax credit as not qualifying as a public assistance since the credit was available to all income levels and not focused on low income taxpayers. The court reviewed the legislative history of the additional child tax credit and noted that several amendments to the original statute increased the availability of the credit to low income taxpayers and added refundability, indicating the intent of Congress to have the additional child tax credit function as public assistance. The court held that the additional child tax credit was eligible for the exemption under Iowa Code § 627.6 as public assistance. In the **Matter of Hatch, 2014-2 U.S. Tax Cas. (CCH) ¶ 50,465 (Bankr. S.D. Iowa 2014)**.

EARNED INCOME TAX CREDIT. The debtor filed for Chapter 7 on March 31, 2014 and had received a federal income tax refund for 2013 on March 4, 2014. The refund included amounts attributable to the earned income credit and child care credit, both of which were claimed exempt from the bankruptcy estate under 735 ILCS 5/12-1001(g)(1). The trustee argued that, by referring only to a debtor's "right to receive" payment, the exemption statute clearly applies only to rights to future payments and not to funds already received or other proceeds of such rights; therefore, the pre-petition receipt of the refund disqualified the refund for the exemption. The court noted that other exemptions allowed for an exemption in traceable proceeds received pre-petition; therefore, the public assistance exemption 735 ILCS 5/12-1001(g)(1) did not apply to pre-petition proceeds because the statute did not provide for any tracing back to the receipt of the proceeds. **In re Frueh, 2014-2 U.S. Tax Cas. ¶ 50,467 (Bankr. N.D. Ill. 2014)**.

## FEDERAL FARM PROGRAMS

**CITRUS**. The AMS has adopted as final regulations that changed the minimum grade requirements prescribed under the marketing order for oranges, grapefruit, tangerines, and tangelos grown in Florida (order). The interim rule reduced the minimum grade requirement for Valencia and other late type oranges shipped to interstate markets from a U.S. No. 1 to a U.S. No. 1 Golden from May 15 through June 14 each season and to a U.S. No.2 external/U.S. No. 1 internal from June 15 through August 31 each season. **79 Fed. Reg. 58663 (Sept. 30, 2014)**.

**FARM LOANS**. The FSA has adopted as final regulations amending the Farm Loan Program (FLP) regulations for loan making and servicing on eligibility conditions for certain legal entities, allowing additional flexibility for loan applicants to meet the required farming experience, and increasing the maximum total indebtedness on Microloans (ML) to $50,000. The regulations amend the definition of an entity in 7 C.F.R. § 761.2 to include a type of organization, as determined by the Secretary, authorized to conduct business in the state in which it operates. There are two types of organizations that continue to be ineligible--estates and nonprofit organizations. The regulations also amend the definition of "family farms" in 7 C.F.R. § 761.2 to specify that family farm" refers to the farm business operation, not real estate. The regulations amend 7 C.F.R. § 762.120 and § 764.152 to allow an applicant that is an entity and that does not own farm land to qualify for an operating loan if the individuals who own the farm own at least 50 percent of a family farm as the operating entity. **79 Fed. Reg. 60739 (Oct. 8, 2014)**.

**ORGANIC FOOD.** The AMS has adopted as final regulations amending the USDA National List of Allowed and Prohibited Substances (National List) to reflect a recommendation submitted to the Secretary of Agriculture by the National Organic Standards Board (NOSB) on October 18, 2012, and removes two previously expired substances. Consistent with the recommendation from the NOSB, the final regulation adds biodegradable bio-based mulch film to the National List with restrictive annotations. The regulations also add a new definition for biodegradable, bio-based mulch film. The regulations also remove two listings for nonorganic agricultural substances from the National List, hops (Humulus lupulus) and unmodified rice starch, as their use exemptions expired on January 1, 2013, and June 21, 2009, respectively. **79 Fed. Reg. 58655 (Sept. 30, 2014)**.

## FEDERAL ESTATE AND GIFT TAXATION

**DISCLAIMERS**. The taxpayer was a contingent reminder holder of income and principal interests in two trusts. The taxpayer filed written disclaimers of the interests within nine months after the taxpayer reached age 18. The taxpayer's interests then passed as provide in the trusts' documents. The IRS ruled that the disclaimers were effective. **Ltr. Rul. 201440007, June 17, 2014**.

# FEDERAL INCOME TAXATION

**BAD DEBTS**. The taxpayer had been involved for approximately 30 years in one or more activities involving real property that included buying, selling, and/or renting certain real property and providing management services for certain rental real property. During the approximately 30 years that the taxpayer was involved in the real property activities, the taxpayer made loans on about six different occasions. At no time during that period did the taxpayer (1) advertise as a money lender or (2) keep a separate office or separate books and records relating to any of the loans. The taxpayer borrowed money from a bank and loaned most of the money to an unrelated person who used the money as a down payment on a residence. The loan was evidenced by a promissory note but was not secured by any property. The evidence showed that the taxpayer made no effort to qualify the borrower for the loan, such as determining the borrower's income, credit rating or assets. The borrower made payment for just over two years before defaulting on the loan. The taxpayer made a few oral attempts to obtain payment but did not pursue any legal remedy nor did the taxpayer file a claim in the borrower's bankruptcy proceedings. The taxpayer claimed only a small portion of the unpaid debt as a loss deduction. The taxpayer claimed that the sole purpose of the debt was to obtain interest income. The court held that the taxpayer was not entitled to a business bad debt deduction for the loan because the taxpayer was not in the business of providing loans and failed to prove that the debt was worthless in the tax year in which the deduction was claimed. **Langert v. Comm'r, T.C. Memo. 2014-210**.

**BUSINESS EXPENSES**. The taxpayer was a lawyer who filed the 2002 through 2006 tax returns in 2008. The returns included a note that the taxpayer had lost all records and that the amounts listed in the returns were estimates within 5 to 10 percent. Some expenses were proved, such as the rent payments for the office, but no evidence to support the other claimed expenses was provided. The court disallowed the unsupported deductions. **Le Beau v. Comm'r, T.C. Memo. 2014-198**.

The taxpayer operated a flooring business and filed returns for 2009 and 2010 prepared by tax return preparers. The taxpayer claimed to have lost most of the business records for 2009 in a flood in the taxpayer's basement. The 2009 return was filed without these records but used bank statements and a few receipts to claim a cost of goods sold amount and business expenses. The tax return preparer did not testify as to how these amounts were determined. The IRS disallowed a portion of the costs of goods sold amount and most of the other expenses for lack of substantiation. The court held that the deductions were allowed only to the extent allowed by the IRS because the taxpayer failed to substantiate any amounts above the allowed deductions. **Nguyen v. Comm'r, T.C. Memo. 2014-199**.

**CAPITAL COSTS**. Several restaurants under examination were shown to be posting ending inventories consisting entirely, or almost entirely, of raw materials, specifically ingredients that had not yet entered the restaurant's production process. The restaurants were generally treating costs incurred related to the kitchen ("back of the house") as capitalizable production costs and costs incurred related to the serving area ("front of the house") as non-capitalizable costs under I.R.C. § 263A. However, some of the restaurants had not capitalized under I.R.C. § 263A certain back-of-the-house costs incurred to produce food, including cook and preparation-cook wages related to producing food (collectively, "kitchen labor"). Treas. Reg. 1.263A-1(f)(1) allows producers to use the simplified production method under Treas. Reg § 1.263A-2(b) to allocate direct and indirect costs to eligible property produced rather than a "facts-and-circumstances" method, which includes a specific identification method, standard cost method, burden rate method, or any other reasonable allocation method (as defined under the principles of Treas. Reg. § 1.263A-1(f)(4)). A reasonable facts-and-circumstances method is generally more precise than the simplified production method because costs can be allocated on the basis of a cause and effect or other reasonable relationship. If kitchen labor were treated as additional I.R.C. § 263A costs under the simplified production method, a significant amount of kitchen labor would be capitalized to the raw materials in ending inventory, even though kitchen labor costs typically relate almost entirely to the production of food that is no longer on hand. However, if kitchen labor were treated as an I.R.C. § 471 cost under the simplified production method or if a more precise facts-and-circumstances method were used, these costs would be allocated to the cost of produced food included in cost of goods sold. In a Chief Counsel Advice letter, the IRS stated that, if the Service imposed the simplified production method with kitchen labor treated as an additional I.R.C. § 263A cost, the restaurant might request to change its method of accounting to treat kitchen labor as a I.R.C. § 471 cost or change to a more precise facts-and-circumstances method and our office generally would grant such changes as appropriate. Consequently, under these facts, even though a restaurant may use the simplified production method, the IRS stated that it would generally not support the imposition of this method in examination or litigation if the taxpayer was willing to develop and implement a reasonable facts-and-circumstances method instead. In addition, under these facts, if the taxpayer uses the simplified production method, the IRS would support allowing the taxpayer to treat all of their direct production costs (including kitchen labor) as I.R.C. § 471 costs under that method rather than as additional I.R.C. § 263A costs. **CCA 201439001, July 24, 2014**.

**CHARITABLE DEDUCTIONS**. The taxpayers, husband and wife, established an irrevocable trust with the proceeds of a life insurance policy on the life of their child. The trust document requires that all income from the trust is to be paid for educational purposes. The taxpayers reserved the right to amend the trust except for the provision that all funds were to be distributed to students for educational purposes. The trust did not apply for tax-exempt status as a charitable organization under I.R.C. § 501. In 2008, the trust made three payments of $2,000 to students from the trust's income. The taxpayers claimed the $6,000 as a charitable deduction. The court held that the charitable deduction was properly disallowed by the IRS because (1) the payments were made by the trust from trust income, (2) the taxpayers were not treated as the owners of the trust and did not report the trust income as their taxable income, (3) the students who received the money were not a a payee listed in I.R.C. § 170, and (4) the taxpayers did not have any evidence of a contemporaneous written acknowledgment of the charitable contribution as required by I.R.C. § 170(f)(8). **Kalapodis v. Comm'r, T.C. Memo. 2014-205**.

The taxpayer claimed deductions for noncash charitable deductions for clothes, household furniture and miscellaneous items from the taxpayer's own possessions and the possessions of the taxpayer's parents. The taxpayer submitted evidence of the donations in the form of pre-signed receipts from the charitable organization which received the items. There was no evidence to support the values claimed for the property and the receipts did not itemize the property donated. The taxpayer claimed to have used an online valuation estimator provided by the Salvation Army. The court disallowed the deductions because the taxpayer failed to maintain sufficient records of the donations, including their value and cost basis, and failed to include a qualified appraisal of the donated property. **Smith v. Comm'r, T.C. Memo. 2014-203**.

**CORPORATIONS**

EMPLOYEES. The taxpayer was a corporation engaged in the business of buying, repairing, reconditioning, and reselling used automobiles. The taxpayer's president was the sole shareholder and the president managed the business of the corporation, including the hiring and firing of employees. The taxpayer's secretary/treasurer was in charge of repair and maintenance of the cars in inventory. The third employee was in charge of picking up and delivering automobiles, including obtaining and delivering license plates and title certificates. The taxpayer treated all three persons as independent contractors, although none of the employees had employment contracts with the taxpayer. The taxpayer did not withhold any income, FICA or FUTA taxes or issue the employees W-2 forms. The court held that the president and secretary/treasurer both performed more than minor services and were statutory employees for employment tax purposes. The court also held that the third worker was also subject to employment taxes under the factors used to determine worker status as a common law employee in that (1) the president of the corporation exercised control over the worker's activities, (2) the worker was not in a position to increase profits through the worker's own efforts, (3) the worker did not employ the worker's own tools, (4) the worker's received compensation categorized as wages every month; and (5) the work performed by the worker's was integral to the corporation's regular business. **Central Motorplex, Inc. v. Comm'r, T.C. Memo. 2014-207**.

**HEALTH INSURANCE**. The IRS has published information on the Small Business Health Care Tax Credit. For tax years beginning in 2014 and after, the maximum credit is 50 percent of premiums paid for small business employers, and 35 percent of premiums paid for tax-exempt small employers, such as charities. The credit is available to eligible employers for two consecutive taxable years. A small business employer who did not owe tax during the year can carry the credit back or forward to other tax years. Also, since the amount of the health insurance premium payments is greater than the total credit claimed, eligible small employers can still claim a business expense deduction for premiums in excess of the credit. For tax-exempt small employers, the credit is refundable. Even if the tax-exempt small employer has no taxable income, it may be eligible to receive the credit as a refund so long as it does not exceed its income tax withholding and Medicare tax liability. Beginning in 2014, a small employer may qualify for the credit if: (1) It has fewer than 25 employees who work full-time, or a combination of full-time and part-time. For example, two half-time employees equal one full-time employee for purposes of the credit. (2) It pays premiums on behalf of employees enrolled in a qualified health plan offered through a Small Business Health Options Program Marketplace or qualifies for an exception to this requirement. (3) The average annual wages of full-time equivalent employees are less than $51,000. The annual average wages will be adjusted annually for inflation. (4) It pays a uniform percentage for all employees that is equal to at least 50 percent of the premium cost of the insurance coverage. **Health Care Tax Tip 2014-20**.

**HEALTH INSURANCE EXCHANGES**. On the issue of whether the health insurance premium tax credit under I.R.C. § 36B can be provided to individuals who obtain individual health insurance coverage on the federal exchange, a U.S. District Court in Oklahoma has ruled against allowing the tax credit from federal exchanges, holding that the phrase "established by the State" refers only to insurance exchanges established by a state and does not include the federal exchanges. **State of Oklahoma v. Burwell, 2014-2 U.S. Tax Cas. (CCH) ¶ 50,459 (E.D. Okla. 2014)**.

**HOBBY LOSSES**. The taxpayer was employed as a professor of art at a college and created artworks for sale and exhibition. The IRS disallowed deductions in excess of income from the art creation activity for five tax years as not resulting from an activity with the intent to make a profit. The IRS argued that the taxpayer's work as a professor and as an artist were one activity; therefore, the art creation expenses were deductible only as unreimbursed employee expenses. The court held that the separation of the professorship from the art creation activity was reasonable since the taxpayer had begun the art creation activity long before becoming a professor and intended to continue the production of artwork after retiring from teaching. The court recognized that the professor position required that the taxpayer continue to produce and exhibit artwork but noted that, as a tenured professor, the taxpayer was no longer required to produce artwork in order to retain her employment. The court held that the taxpayer's art creation activity was entered into with the intent to make a profit because (1) the taxpayer maintained complete and accurate records and pursued an active marketing program of exhibitions and new work; (2) the taxpayer was an expert artist who relied on galleries for advice about marketing; (3) the taxpayer spent significant amounts of time on producing and marketing the artwork; (4) the taxpayer had a reasonable expectation that the artwork would appreciate in value over the years; and (5) the taxpayer was successful in the teaching world in an activity closely related to the artwork business. The court noted that, although the production of art had a significant amount of personal pleasure, the court found that the taxpayer's skill and effort raised the activity above mere personal pleasure. The court held that the five factors above outweighed the five years of continuous losses and rare profits. **Crile v. Comm'r, T.C. Memo. 2014-202**.

**INNOCENT SPOUSE RELIEF**. The taxpayer and spouse were married during the tax years involved and were still married at the time of trial in this case. The taxpayer worked part time as an office manager for the spouse and even performed legal work for the spouse's law practice. The couple filed joint income tax returns which were prepared by the spouse and not thoroughly reviewed by the taxpayer. The IRS assessed deficiencies and penalties for both returns because the spouse claimed personal expenses as business deductions. The court held that the taxpayer was not entitled to innocent spouse relief under I.R.C. § 6015(b) because (1) the taxes owed were attributable to the spouse's business in which the taxpayer participated and (2) the disallowed deductions giving rise to the taxes were attributable to personal expenses from which the taxpayer benefitted. The court held that the taxpayer was not entitled to innocent spouse relief under I.R.C. § 6015(c) because the taxpayer and spouse were still married. The court also held that the taxpayer was not entitled to equitable innocent spouse relief under I.R.C. § 6015(f) and *Rev. Proc. 2013-34, 2013-2 C.B. 397* because (1) the couple had the title to their residence changed to be solely the name of the taxpayer and (2) the taxes were attributable to the taxpayer's employment in the law practice. **Wang v. Comm'r, T.C. Memo. 2014-206**.

**INSTALLMENT REPORTING**. The taxpayer was an S corporation which owned and operated a pharmacy. The taxpayer was solely-owned by one person who was the pharmacist. The taxpayer entered into a contract to sell the assets of the business for cash and a 15-year promissory note. On the tax return the taxpayer elected to report all the gain in one tax year. The taxpayer requested a ruling to allow revocation of that election. Treas. Reg. § 15A.453-1(d)(4) provides that generally an election out of installment reporting is irrevocable. An election out may be revoked only with the consent of the Commissioner. A revocation, which is retroactive, will not be permitted when one of its purposes is the avoidance of federal income taxes, or when the taxable year in which any payment was received has closed. In this case, the taxpayer submitted factual information indicating that granting its request for a ruling will not result in the avoidance of federal income taxes. Moreover, none of the taxable years in which any affected payment was received was closed. The IRS granted the taxpayer permission to revoke the election out of installment reporting. by filing an amended return within 75 days. **Ltr. Rul. 201440004, June 26, 2014**.

**INVOLUNTARY CONVERSIONS**. Under I.R.C. § 1033(e)(2)(B), the standard replacement period (four years after the close of the first taxable year in which any part of the gain from a drought sale occurs) can be extended by the Secretary of the Treasury if the Secretary determines that the drought area was eligible for federal assistance for more than three years. See *Notice 2006-82, 2006-2 C.B. 529*. The IRS, after consultation with the National Drought Mitigation Center, publishes in September of each year a list of counties for which exceptional, extreme, or severe drought was reported during the preceding 12 months. Taxpayers may use this list instead of U.S. Drought Monitor Maps to determine whether a 12 month period ending on August 31 of a calendar year includes any period for which exceptional, extreme, or severe drought is reported for a location in the applicable region. The IRS has published a list of the counties and parishes in the United States that have suffered exceptional, severe or extreme drought during the 12 months ending August 31, 2014, sufficient to extend the livestock replacement period. **Notice 2014-60, I.R.B. 2014-43.**

**LODGING EXPENSES**. Under the general rule, local lodging expenses for an individual are personal, living, or family expenses that are nondeductible by the individual under I.R.C. § 262(a). Depending on the facts and circumstances, however, local lodging expenses may be deductible under I.R.C. § 162 as ordinary and necessary business expenses. The IRS has adopted as final regulations providing a safe harbor, pursuant to which local lodging expenses that meet certain criteria are treated as ordinary and necessary business expenses of an individual. An individual's local lodging expenses will be treated as ordinary and necessary business expenses if—(1) the lodging is necessary for the individual to participate fully in or be available for a bona fide business meeting, conference, training activity, or other business function; (2) the lodging is for a period that does not exceed five calendar days and does not recur more frequently than once per calendar quarter; (3) if the individual is an employee, the employee's employer requires the employee to remain at the activity or function overnight; and (4) the lodging is not lavish or extravagant under the circumstances and does not provide any significant element of personal pleasure, recreation, or benefit. Local lodging expenses that meet either the facts and circumstances test of Treas. Reg. § 1.162-32(a). or the safe harbor requirements of Treas. Reg. § 1.162-32(b) are deductible by an individual if incurred directly. Alternatively, if the expenses are incurred by an employer on behalf of an employee, the value of the local lodging may be excludible from the income of the employee as a working condition fringe under I.R.C. § 132(a) and (d). To the extent an employer reimburses an employee for local lodging expenses, the reimbursement may be excludible from the employee's gross income if the expense allowance arrangement satisfies the requirements of an accountable plan under I.R.C. § 62(c) and the applicable regulations. The expenses are also deductible by the employer as ordinary and necessary business expenses. The final regulations contain several examples to illustrate the new facts and circumstances test and the safe harbor rules. **T.D. 9696, 79 Fed. Reg. 59112 (Oct. 1, 2014)**.

**LOSSES.** Section 1409 of the Health Care and Education Reconciliation Act of 2010 (Act), Pub. L. No. 111-152, added I.R.C. § 7701(o) which provides that, in the case of any transaction to which the economic substance doctrine is relevant, the transaction shall be treated as having economic substance only if (1) the transaction changes in a meaningful way (apart from federal income tax effects) the taxpayer's economic position, and (2) the taxpayer has a substantial purpose (apart from federal income tax effects) for entering into the transaction. I.R.C. § 7701(o)(5)(A) states that the term "economic substance doctrine" means the common law doctrine under which tax benefits under subtitle A with respect to a transaction are not allowable if the transaction does not have economic substance or lacks a business purpose. I.R.C. § 7701(o)(5)(C) states that the determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if I.R.C. § 7701(o) had never been enacted. With respect to individuals, however, I.R.C. § 7701(o)(5)(B) states that the two-prong analysis in I.R.C. § 7701(o)(1) shall apply only to a transaction entered into in connection with a trade or business or an activity engaged in for the production of income. In addition, I.R.C. § 7701(o)(5)(D) states that the term "transaction" as used in I.R.C. § 7701(o) includes a series of transactions. I.R.C. § 7701(o)(2)(A) provides that a transaction's potential for profit shall be taken into account in determining whether the requirements of I.R.C. § 7701(o)(1) are met only if the present value of the reasonably expected pre-tax profit is substantial in relation to the present value of the claimed net tax benefits. The Act also added I.R.C. § 6662(b)(6), which provides that the accuracy-related penalty imposed under I.R.C. § 6662(a) applies to any underpayment attributable to any disallowance of a claimed tax benefit because of a transaction lacking economic substance (within the meaning of I.R.C. § 7701(o)) or failing to meet any similar rule of law (collectively a I.R.C. § 6662(b)(6) transaction). The Act also added I.R.C. § 6662(i), which increases the accuracy-related penalty from 20 to 40 percent for any portion of an underpayment attributable to one or more I.R.C. § 6662(b)(6) transactions with respect to which the relevant facts affecting the tax treatment are not adequately disclosed in the return or in a statement attached to the return. Furthermore, new I.R.C. § 6662(i)(3) provides that certain amended returns or any supplement to a return shall not be taken into consideration for purposes of I.R.C. § 6662(i). The IRS has provided additional guidance as to the definition of "transaction" and "similar rule of law." For purposes of determining whether the codified economic substance doctrine applies, "transaction" generally includes all the factual elements relevant to the expected tax treatment of any investment, entity, plan, or arrangement; and any or all of the steps that are carried out as part of a plan. Facts and circumstances determine whether a plan's steps are aggregated or disaggregated when defining a transaction. For purposes of I.R.C. § 6662(b)(6), "similar rule of law" means a rule or doctrine that disallows the tax benefits under subtitle A of the Code related to a transaction because: (1) the transaction does not change a taxpayer's economic position in a meaningful way (apart from federal income tax effects); or (2) the taxpayer did not have a substantial purpose (apart from federal income tax effects) for entering into the transaction. **Notice 2014-58, I.R.B. 2014-44, *amplifying*, Notice 2010-62, 2010-40 C.B. 411.**

**MEDICAL EXPENSES**. The taxpayer claimed a medical deduction for the expense of constructing and maintaining a swimming pool. The taxpayer provided no evidence to support the claim of a medical purpose for the pool other than a doctor's advice for the taxpayer to lose weight. The court disallowed the medical deduction for lack of proof of any medical necessity for the pool. **Le Beau v. Comm'r, T.C. Memo. 2014-198**.

**PARTNERSHIPS**

ELECTION TO ADJUST BASIS. The taxpayer was a partnership in which interests in the partnership were sold during the tax year. The partnership did not realize it could elect to adjust the basis of its property under I.R.C. § 754 and failed to make the election for the tax year of the transfers. The IRS granted an extension of time to file the election on an amended return. **Ltr. Rul. 201440003, May 6, 2014**.

**PENSION PLANS**. For plans beginning in October 2014 for purposes of determining the full funding limitation under I.R.C. § 412(c)(7), the 30-year Treasury securities annual interest rate for this period is 3.26 percent. The 30-year Treasury weighted average is 3.40 percent, and the 90 percent to 105 percent permissible range is 3.06 percent to 3.56 percent. The 24-month average corporate bond segment rates for October 2014, without adjustment by the 25-year average segment rates are: 1.17 percent for the first segment; 4.07 percent for the second segment; and 5.17 percent for the third segment. The 24-month average corporate bond segment rates for October 2014, taking into account the 25-year average segment rates, are: 4.99 percent for the first segment; 6.32 percent for the second segment; and 6.99 percent for the third segment. **Notice 2014-62, I.R.B. 2014-44**.

The IRS has adopted as final regulations that amend the regulations regarding excepted benefits under the Employee Retirement Income Security Act of 1974, the Internal Revenue Code, and the Public Health Service Act. Excepted benefits are generally exempt from the health reform requirements that were added to those laws by the Health Insurance Portability and Accountability Act and the Patient Protection and Affordable Care Act. In addition, eligibility for excepted benefits does not preclude an individual from eligibility for a premium tax credit under I.R.C. § 36B if an individual chooses to enroll in coverage under a Qualified Health Plan through an Affordable Insurance Exchange. **T.D. 9697, 79 Fed. Reg. 59130 (Oct. 1, 2014)**.

**S CORPORATIONS**

SHAREHOLDER BASIS. The taxpayers owned all the shares of an S corporation which owned an interest in a limited partnership. The partnership developed, financed, constructed, owned and operated a low-income rental apartment complex. The partnership received a subaward under the American Recovery and Reinvestment Tax Act of 2009 (the Act). As provided by *Notice 2010-18, 2010-1 C.B. 525*, the Act provides that such subawards are excluded from the gross income of recipients, are exempt from taxation and do not reduce the basis of the apartment complex. The IRS ruled that the taxpayers' bases in their interests in the S corporation was increased by their share of the subaward which passed through from the partnership and S corporation. The IRS also ruled that the S corporation's share of the subaward would not be included in the accumulated adjustments account because the subaward was exempt from taxation. **Ltr. Rul. 201440013, June 24, 2014**.

**SHAM TRANSACTIONS**. The taxpayer owned and operated a cabinet door business for over 20 years as an S corporation. The taxpayer dissolved and liquidated the corporation and sold the business assets to a "PRIVATE, NON-STATUTORY, NON-ASSOCIATED, CONTRACTUAL PURE TRUST (CPT)." The trust was formed by two unrelated persons and the trustee was a friend of the taxpayer. The trust was divided into 100 units with most of the units given to the taxpayer's children and other relatives. The taxpayer formed a limited liability company which operated the business. The trust entered into an option contract to purchase the business property and equipment with the understanding that the trust would lease the property back to the LLC. The LLC made rental payments to the trust which passed on the payments to the taxpayer. The IRS assessed taxes on the sale of the business property to the LLC, arguing that the trust was a sham. The court agreed holding that the trust was a sham because (1) the taxpayer remained the true earner of all income, (2) the taxpayer continued to own most of the assets during the time involved, and (3) the trust was not managed separately from the business. **Wheeler v. Comm'r, T.C. Memo. 2014-204**.

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